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OO RUEHROV
DE RUEHTV #0662/01 0801304
ZNY CCCCC ZZH
O 201304Z MAR 08
FM AMEMBASSY TEL AVIV
TO RUEHC/SECSTATE WASHDC IMMEDIATE 5943
INFO RUEHXX/ARAB ISRAELI COLLECTIVE IMMEDIATE
RUEHFR/AMEMBASSY PARIS IMMEDIATE 1665
RHEHNSC/NSC WASHDC IMMEDIATE
RUEATRS/DEPT OF TREASURY WASHDC IMMEDIATE

C O N F I D E N T I A L SECTION 01 OF 03 TEL AVIV 000662

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NEA/FO FOR DANIN; NEA/IPA FOR GOLDBERGER, SHAMPAINE,
ZIMMER, SACHAR; EEB/FO FOR DIBBLE; EEB/IFD FOR GARRY; PARIS
FOR USOECD JMCCRACKEN; TREASURY FOR CONNOLLY; NSC FOR ABRAMS

E.O. 12958: DECL: 03/19/2018
TAGS: [ECON](#) [EFIN](#) [PGOV](#) [OECD](#) [PREL](#) [IS](#) [KWBG](#)
SUBJECT: BOI GOVERNOR FISCHER -- FINANCIAL CRISIS HAS NOT
YET HIT ISRAEL

Classified By: Ambassador Richard H. Jones for reasons 1.4 b and d.

Summary

1. (C) Meeting on the day after a major decline in stock markets worldwide, Governor of the Bank of Israel Stanley Fischer told the Ambassador on March 18 that the world economy is still closely tied to the U.S. He said that the Federal Reserve Board and EU Central Banks have both performed well during the crisis, but expressed irritation with articles and statements which inflame public sentiment and erode confidence in the world financial system. Fischer stated that Asia and Israel have not yet been deeply affected by the financial crisis, although Israeli exporters have sought support from the government in the face of the surging shekel. He was concerned that falling stock prices would make it harder for companies to raise capital, leading eventually to declining investment. On fiscal issues, Fischer said that the GOI has overpromised on spending and that annual expenditures would have to rise dramatically to fulfill these promises. The GOI needs to formulate and stick to a simple fiscal rule to determine its annual spending increases. He advised the USG to weigh in with its concerns regarding spending pressures on the GOI and speculated that the government would ultimately settle on an expenditure increase of 2.5 percent for 2009. Regarding the OECD accession process, which Fischer referred to as "remarkably far-reaching," he said that all was going well. Fifteen teams have been set up to meet with OECD counterparts to work on updating Israeli laws and regulations in a wide variety of areas and the Ministry of Justice is working on passage of the necessary anti-bribery legislation. Fischer said that the Ministry of Foreign Affairs wanted Embassy Tel Aviv to be the point of contact for the USG on all OECD-related issues. Fischer also discussed the Israeli-Palestinian correspondent banking relationship (reported septel). End Summary

World Economy Still Tied to U.S.

2. (C) The Ambassador met with Governor of the Bank of Israel Stanley Fischer on March 18, at a time of severe weakness in the dollar and turmoil in world financial markets. Fischer said that this crisis is less complex than some others in recent memory, but said that it is more important in terms of impact on the global economy. The U.S. economy is now less dominant than in the past due to the rise of Asia and the EU, comprising only 22 percent of the world

economy now, compared to 50 percent in 1950. However, the world has by no means "decoupled" from the U.S. economy and Israel in particular is very much affected by it. The present crisis has not yet affected Asia nor had a big impact in Israel, although exporters have asked for government assistance in the face of the surging shekel. However, the worldwide decline in stock prices -- including in Israel where the market fell four percent on March 17 -- will make it more difficult for companies to raise capital and likely lead to reduced investment.

Central Banks Doing Well

13. (C) Fischer praised the Federal Reserve Board for its handling of the crisis and noted that the EU Central Bank has shown its maturity by responding quickly and properly, in marked contrast to its handling of past crises. He noted that the Central Banks had maintained liquidity in the markets, but were now grappling with the problem of how to restore confidence in the banking system. He described the role of a central bank and its relationship to a country's treasury in some detail, noting that there is a limit to how many failed institutions a central bank can absorb before it begins to materially affect the amount of money circulating in the economy.

Everyone Should Just Keep Quiet

14. (C) Fischer also stressed the importance of psychology in handling a financial crisis of this magnitude, noting that

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the worst thing to do is to fan the flames of public concern. He expressed particular irritation with statements and articles which cause panic and erode public confidence in the worldwide financial system. Regarding recent discussion of losses in local pension funds, Fischer was not concerned, saying that this simply reflected the state of the international financial markets. On the movement of bond funds, which have been increasing in value as interest rates have gone down, he said that "they love declining interest rates, not low interest rates."

GOI Has Made Too Many Promises

15. (C) In response to the Ambassador's comment on the pressure on the government to increase spending, Fischer noted that all of the government's recent spending commitments are in the form of promises for the future. However, at some point, he added, promises have to be acted on, and a BOI report to be released soon documents that fulfilling the accumulated promises would require raising spending by much more than the presently-accepted 1.7 percent year-to-year increase. In the past, the MOF has succeeded in "squashing" most demands for increased spending, but that will become harder to do. Fischer stressed that "the government's credibility depends on how it deals with spending." Finance Minister Bar-On is very tough on the issue and the new Budget Director Ram Belinkov is, if anything, even tougher. than his predecessor. However, Belinkov, who, according to Fischer would actually prefer to lower the 1.7 figure, lacks previous Budget Director Kobi Haber's diplomatic skills and his tough stance will likely engender angry reactions. The Prime Minister is aware of the issue, but Fischer advised the USG to make its views known as well. He also agreed with the Ambassador's suggestion to continue to discuss the issue as the JEDG (Joint Economic Development Group) meeting approaches later this year.

Stick to a Simple Fiscal Rule

¶6. (C) With the government spending to GDP ratio already down to about 44.5 percent - below the OECD average -- and close to the U.S. figure of about 38 percent if defense spending is taken out of the calculation, Fischer maintained that it would actually be unreasonable for an Israel steadily growing at a three to five percent clip to keep yearly expenditure increases to 1.7 percent for much longer. He said that more important than the growth figure itself, which could even be three percent as far as he was concerned, was the need to establish a simple fiscal rule to arrive at a figure and then stick to it. He said that sensible -- but too complicated -- formulas must be avoided.

2.5 Percent Figure Likely

¶7. (C) Fischer said that at the JEDG last year, the GOI tossed out a "Trojan Horse" regarding its goal for the growth figure when it noted the intent to steadily increase the defense budget by 2.5 percent per year. He speculated that this is where the future general budget expenditure figure will probably end up, and added that it is also not high enough to meet all of the government's recent budgetary "promises." This will be particularly the case if, as he expects, there is lower growth than in the past few years.

OECD Accession Going Well

¶8. (C) On the OECD accession process, Fischer said that Israel is "in good shape on the essentials." The first draft of Israel's response to the OECD "accession roadmap" was now being circulated throughout the government and that the process was going well. The OECD Secretary General with whom he had just met, also seemed to be pleased with the progress being made on Israel's accession. On the anti-bribery issue, the Ministry of Justice is now beginning the process to get the needed legislation passed by the Knesset. Fischer had no particular information on IPR, but said that Israel's

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environmental policies are coming under critical scrutiny. The OECD seems to be satisfied with Israel's capital markets reforms, but there is a need for a bit more transparency in the budget process, especially with regard to the MOF's special powers vis-a-vis other ministries in the government. Some areas of labor and wage law need to be addressed, as does the treatment of Palestinian and other foreign workers in Israel.

Teams Examining Wide-Ranging Issues

¶9. (C) When the Ambassador mentioned Fischer's remark at a previous meeting that OECD accession would help advance a reform agenda in Israel, Fischer agreed, noting that there are many areas in which Israel can use OECD regulations as a standard of comparison. He said that not all current OECD members adhere to all existing regulations, but that new members are expected to. Calling the accession process "remarkably far-reaching," Fischer noted that the GOI has set up fifteen teams to work with OECD counterparts on a wide variety of issues. The economic and financial markets teams will be led by the BOI, and the Bank will also be represented on all of the other committees in which its expertise is relevant. Along with representatives from all interested government ministries, these teams will also include observers from non-governmental organizations as well. He cited as an example that environmental groups will observe

the deliberations of the environment committee. Fischer added that another positive outgrowth of this process would be an improvement in inter-ministerial communication within the GOI.

Veto of Israeli Accession Unlikely

¶10. (C) In response to the Ambassador's query whether he was concerned that political considerations might cause a current OECD member to veto Israel's application to join, Fischer said that while the OECD is a consensus organization, there is tremendous pressure within it not to veto an application which clearly merits positive consideration. Therefore, he did not think that the possibility of a veto was of concern. With regard to communicating with the USG on OECD-related issues, Fischer said that the Ministry of Foreign Affairs expressed the strong preference that the Embassy in Tel Aviv be the main point of contact. This would be a general practice; managing contacts with multiple agencies in thirty member states would simply be impossible.

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JONES